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INFO RUEHBJ/AMEMBASSY BEIJING 2745
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E.O. 12958: N/A
TAGS: CH ECON EFIN KPAO PGOV PREL SOCI
SUBJECT: (SBU) EAST CHINA ANXIOUS OVER CHINA'S DOLLAR HOLDINGS

¶1. (SBU) Summary. East China reporters and academics interacting with visiting Dallas Federal Reserve Bank President Richard W. Fisher repeatedly raised the possibility of a link between current U.S. monetary and fiscal policy expansion and future U.S. inflation. One of the most vocal academic critics implied that China is right to move away from U.S. dollar-denominated assets, since these are likely to decline in value. The interlocutors were concerned whether the U.S. economy has hit bottom. They also sought the visitors' perspective on China's first steps toward taking a more active role in the international financial system. End summary.

¶2. (SBU) President Fisher, Vice President Mark A. Wynne, and Senior Research Economist Tao Wu, all from the Dallas Fed, held a press conference and then joined academics in a small roundtable discussion during their visit to Shanghai on April
¶19. Fifteen media outlets were represented, including 21st Century Business Herald , China Daily, Bloomberg, Dow Jones, China Market News, Shanghai Daily, International Finance News, Oriental Morning Post, Shanghai TV's Business Channel, China Business News, Shanghai Business News, Shanghai Morning Post, Shanghai Financial News, the Economic Observer, and Bund Pictorial. Academics participating in the roundtable included Pan Yingli, Jiaotong University; Sun Lijian, Fudan University; Chang Chun, China Europe International Business School (CEIBS); Tian Boping, Jiangsu Academy of Social Sciences; Chen Baomin, Nanjing University; and Wang Zhikai, Zhejiang University.

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Fears That U.S. Inflation Will Diminish the Dollar's Value
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¶3. (SBU) Reporters and academics interacting with President Fisher in Shanghai repeatedly raised the possibility of a link between current U.S. monetary and fiscal policy expansion and future U.S. inflation. During the media roundtable, questions ranged from the Oriental Morning Post's "Will there be a dollar crisis?" to more specific ones, such as the 21st Century Business Herald's "Will the Fed's purchase of US$300 billion in

U.S. Treasuries decrease the value of the dollar?" and Dow Jones' "Given that the United States does not want IMF oversight, what can the U.S. government do to reassure China over its concerns about the dollar?"

¶4. (SBU) The academics revealed a strongly held presumption that there is a direct relationship between today's U.S. market stabilization measures and future inflation. Zhejiang University's Wang asserted that U.S. inflation will eventually reduce the value of China's dollar-denominated assets. Jiaotong's Pan was the most vocal critic. At one point, President Fisher prefaced his response to another academic--who asked whether the U.S. would guarantee returns on U.S. Treasuries--with the statement that the value of Treasuries is set by markets, so no one could provide a guarantee. President Fisher went on to explain that the Fed governors were viscerally opposed to allowing an inflation spiral that would erode the value of Treasuries, but Pan seemed to hear only the first remark. She snorted and said aloud, "I knew that there could be no guarantee." Pan later chuckled when President Fisher mentioned that China had slowed its purchases of Treasuries in the first two months, implying that China is right to reject an asset that would decline in value. (Note: Pan is reputed by our contacts to have had significant input into People's Bank of China Governor Zhou Xiaochuan's recent proposal to find a substitute for the U.S. dollar in the international monetary system. End note.)

¶5. (SBU) Pan questioned President Fisher further on future Fed management of the money supply. We expect that inflation will rise, she said, so what plans does the Fed have to soak up the excess liquidity? Pan commented that it is sometimes difficult

to see inflation coming in the globalized economy, since inflation can be imported from trading partners. She posited the following scenario: Several countries with reserve currencies expand their money supplies and boost their imports. As a result of the higher demand, an inflation cycle starts in the exporting countries. Since this inflation does not show up in the domestic indicators of the importing countries, the money supplies there are not reined in. Eventually, the inflation does show up domestically, but by then it is too late to stop.

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"Have We Seen the Bottom?"
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¶6. (SBU) The reporters and academics were also focused on when the U.S. economy would begin to recover. Jiaotong's Pan simply asked, "Has the United States hit bottom? How much farther will the U.S. housing market fall?" CEIBS's Chang asked about the U.S. Treasury's plans to dispose of "toxic" assets, while noting that even without details of the Public Private Investment Program, the stock market was already rising. Was this a false dawn? Chang wondered.

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Seeking Perspective on China's Role
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¶7. (SBU) Another common thread in the reporter's questions was to seek the U.S. perspective on China's more visible role in the international financial system. Two reporters asked for President Fisher's view on internationalization of the renminbi. Did President Fisher approve of the Chinese Government's recently announced move to allow the renminbi to be used for settlement of some trade contracts? Would this have an impact on the U.S. dollar? queried a China Business News reporter, echoed later by a China Daily reporter. The China Daily reporter also asked for President Fisher's views on China's domestic economy: "Why is China able to have such a high economic growth rate?"

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Comment

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¶8. (SBU) Those meeting with President Fisher appeared to appreciate the clear anti-inflation, strong dollar message that he delivered. However, not all appeared to be convinced--Jiaotong's Pan, for instance, continued her criticisms of U.S. monetary policy in talks with other academics as the group departed. Both the reporters and the academics sometimes appeared to underestimate the independence of the Fed in setting monetary policy. The questions also demonstrated what President Fisher called the "burden" of being the world's largest economy: in the same forum, one person might imply that the United States should grow faster, while another would express concerns about possible inflation. In a more nuanced mode, both Pan and CEIBS's Chang asserted that former Treasury Secretary Paulson and then New York Fed President Geithner standing together as financial stabilization measures were announced created the image that the Fed was doing the bidding of political authorities.

¶9. (SBU) It may be that Chinese misperceptions of the Fed's role have been fed by the 2007 book "Currency Wars" (Huobi Zhanzheng), a popular work still prominently displayed on many local bookstore shelves that borrows liberally from conspiracy theories that the Fed does the bidding of its member banks, and is not to be trusted as an independent monetary authority.

¶10. (U) The Dallas Fed delegation has cleared on this cable.
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